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Taxation

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TAXATION

by

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I. LIMITED SALES, EXCISE, AND USE TAX

A. Application of the Tax

THE courts decided few sales tax cases during the survey period, although several significant sales tax cases were pending at the close of the survey period,[1] and others remain subject to further judicial review.[2] The taxpayer-corporation in *Reveille Tool & Supply, Inc. v. Texas*[3] had filed articles of dissolution with the Secretary of State in December 1982, the month after the corporation had requested that the comptroller redetermine a deficiency determination. Pursuant to the comptroller's redetermination, tax became due and payable on September 25, 1984. On January 31, 1986, the state filed suit to recover taxes. The taxpayer argued that the suit had been filed more than three years from the date of the corporation's dissolution, and was therefore barred by the statute of limitations.[4] The court held, however, that the state had commenced an administrative "proceeding" within three years of the dissolution and thus had satisfied the statutory requirement that an action or "other proceeding" commence within three years of dissolution.[5]

The United States Supreme Court's decision in *D.H. Holmes Co., Ltd. v. McNamera*[6] may have broad Texas sales and use tax implications. In *Holmes* the Court upheld Louisiana's imposition of use tax on catalogues for D.H. Holmes department store.[7] Although out-of-state companies prepared and mailed the catalogues, eighty-two percent of the catalogues were mailed to Louisiana residents. The Supreme Court concluded that "[t]here is nexus

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1. *E.g.*, Spencer Gifts, Inc. v. Bullock, No. 2-88-079-CV (Tex. App.—Austin) (not yet reported) (concerning the taxability of certain "handling" charges with respect to catalog sales).

2. *See, e.g.*, Bullock v. Texas Monthly, Inc., 731 S.W.2d 160 (Tex. App.—Austin 1987, writ ref'd n.r.e.), *rev'd*, 109 S. Ct. 890, 102 L. Ed.2d (1989) (concerning exemption for religious periodical under TEX. TAX CODE ANN. § 151.312 (Vernon 1982)). Subsequent to the survey period, the Supreme Court, in a divided opinion, struck down the Texas statute as unconstitutional.

3. 756 S.W.2d 102 (Tex. App.—Austin 1988, no writ).

4. *See* TEX. BUS. CORP. CODE ANN. art. 7.12 (Vernon Supp. 1989).

5. 756 S.W.2d at 103.

6. 108 S. Ct. 1619, 100 L. Ed. 2d 21 (1988).

7. 108 S. Ct. at 1625, 100 L. Ed. 2d at 25.

aplenty here," and distinguished *Holmes* from the landmark *National Bellas Hess, Inc. v. Department of Revenue.*[8]

Several administration decisions focus on issues that are likely to recur both in their original context and in the context of the Texas sales tax as it applies to services. Decision 21,970,[9] for example, which deals with the taxability of rental receipts on floating buildings, addressed issues that also arise in determining which services are related to real property.[10] This decision distinguished real property from personal property and concluded that the buildings were nontaxable real property. The decision indicated that while the intention of the parties is the most important factor, objective factors such as the method by which property is attached to real property also required consideration.[11]

Other administrative decisions evidence the difficulty of allocating only a portion of a purchase price to a taxable sale. Decision 21,868,[12] for example, discussed at some length the proper criteria for determining which charges were allocable to taxable scaffold erecting and which charges were allocable to nontaxable dismantling.[13] Decision 21,837[14] distinguished a sale of tangible property from a sale of intangible information, and concluded that a purchaser of coupon books buys the tangible coupons rather than the information represented by the books.[15] Decision 22,542[16] emphasized literal statutory language and concluded that tax should be imposed only on the "performance" of a taxable service.[17] In addition, the decision concluded that a cable company's customer deposits were not charges for the performance of a service and were therefore not taxable.[18]

Decision 21,826[19] addressed the prerequisites for the grandfather protection afforded certain transactions by 1984 legislative changes.[20] In a deci-

8. 386 U.S. 753 (1967).

9. Comptroller Hearing No. 21,970 (Feb. 17, 1988).

10. *See* Comptroller Hearing No. 21,788 (May 31, 1988) (concluding that specified equipment used in bowling alley was real rather than personal property). Decision 21,788 is also interesting for its observation that the Tax Division had altered its position on the classification of bowling equipment. *Id. See also* Comptroller Hearing No. 21,177 (Sept. 23, 1987) (cooler/freezer units were improvements to realty); Comptroller Hearing No. 21,689 (Mar. 14, 1988) (floor-to-ceiling wall systems were personal rather than real property, and labor charges allocable to installation were not separately stated; therefore, charges were taxable).

11. Comptroller Hearing No. 21,970 (Feb. 17, 1988).

12. Comptroller Hearing No. 21,868 (July 29, 1988) (this decision discusses detrimental reliance).

13. *See also* Comptroller Hearing No. 22,613 (May 12, 1988) (portion of membership cost in video rental store that does not entitle member to tapes is nontaxable); Comptroller Hearing 22,414 (June 9, 1988) (discussing "hybrid" transactions and reiterating that "essence of the transaction" test is proper test for determining whether certain sales are taxable).

14. Comptroller Hearing No. 21,837 (Dec. 10, 1987).

15. *Id.* The administrative law judge distinguished this situation from the sale of key punch cards, by which the purchaser buys information.

16. Comptroller Hearing No. 22,542 (June 15, 1988) (relying on the TEX. TAX CODE ANN. § 151.005(3) (Vernon Supp. 1988) definition of taxable service as "the performance of a taxable service").

17. Comptroller Hearing No. 22,542 (June 15, 1988).

18. *Id.*

19. Comptroller Hearing No. 21,826 (May 23, 1988).

20. *See* TEX. TAX CODE ANN. § 151.339 (Vernon Supp. 1988).

sion that the comptroller may attempt to rely on in interpreting more recent grandfather provisions,[21] the administrative law judge concluded that a seller whose contract allowed it to adjust charges after six months was unable to qualify for grandfather protection.[22] According to the decision, the contract was subject to change or modification by reason of the tax, and "it mattered not that the taxpayer elected not to change the contract."[23]

Decisions 21,525[24] and 21,314[25] both addressed agency issues. In Decision 21,525 the taxpayer sought credit for a tax payment made by its parent corporation, on the grounds that the parent was acting as taxpayer's agent. The administrative law judge found, however, that the parent was not subject to the taxpayer's control and was therefore not its agent.[26] The taxpayer in Decision 21,314[27] denied tax liability on the grounds that it made purchases as an agent for its customer, and that agents should not be held liable for sales tax. The decision concluded, however, that the sales tax was transactional and applied not to the ultimate owner but to the person actually involved in the sale or purchase,[28] and that the agency issue, therefore, was meaningless.[29]

As in most recent survey periods the comptroller decided numerous decisions on the "sixty-day rule,"[30] which requires resale certificates to be timely submitted to the comptroller during audit. As in the past, the comptroller generally ruled against the taxpayer, but the decisions raised some interesting issues.[31] Other decisions emphasize the broad liability of taxpayers,[32]

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21. *See* Act of July 21, 1987, ch. 5, 2d Called Session, Tex. Session Law Serv. 20 (Vernon) (exemption until July 1, 1990 from rate increase for certain sales pursuant to prior contract); Act of July 21, 1987, Tex. Sess. Law Serv. 43 (Vernon) (exemption until Jan. 1, 1990 from tax on certain sales of services pursuant to prior contract).

22. Comptroller Hearing No. 21,826 (May 23, 1988).

23. *Id. See also* 34 TEX. ADMIN. CODE § 3.319 (eff. Apr. 1, 1988, 13 Tex. Reg. 1340) which sets forth comptroller's rules with respect to prior contract exemptions and includes a form for claiming a prior contract exemption.

24. Comptroller Hearing No. 21,525 (Mar. 24, 1988).

25. Comptroller Hearing No. 21,314 (Apr. 5, 1988).

26. Decision 21,525 cites First National Bank of Mineola v. Farmers & Merchants State Bank of Athens, 417 S.W.2d 317, 330 (Tex. Civ. App.—Austin 1967, writ ref'd n.r.e.) as authority for the "control" test. The comptroller's refusal to recognize an agency relationship in this situation may be inconsistent with attempts by some auditors to impute business activities of one entity to another to establish doing business in Texas for franchise tax purposes.

27. Comptroller Hearing No. 21,314 (April 5, 1988).

28. *Id.*

29. The decision therefore held that one who is the de facto purchaser of a taxable item, or pays consideration for the item, and "whose only defense against the tax is simply that he was an agent, *can* be held liable for any tax shown to be due." *Id.* (emphasis in original).

30. *See*, Comptroller Hearing No. 21,321 (Nov. 9, 1987) (comptroller is without authority to extend 60 day period and cannot be estopped by actions of his agents). *But see* Comptroller Hearing No. 22,423 (May 12, 1988) (auditor's sending final determination to taxpayer prior to expiration of 60 days disrupted 60-day time frame so that taxpayer was not given requisite 60 days).

31. *See*, Comptroller Hearing No. 22,924 (July 20, 1988) (60 day period not tolled by bankruptcy proceeding).

32. *See* Comptroller Hearings No. 22,538 (Apr. 20, 1988) and 21,709 (Sept. 4, 1987) (finding taxpayers liable under TEX. TAX CODE ANN. § 151.613 (repealed 1988) for tax liability of predecessors). The successor liability provision under current law is broader than in 1982. *See* TEX. TAX CODE ANN. § 111.020 (Vernon Supp. 1988) (extends not only to sales taxes, but

the difficulty of determining what constitutes an occasional sale,[33] and the continuing uncertainty over what constitutes an assignment of a lease for sales tax purposes.[34] Several administrative cases set forth the standards for proving that a taxpayer has relied to its detriment on advice from the comptroller.[35]

B. Administrative Developments

The comptroller issued significant new rules and revised numerous existing rules during the survey period. Many of these rules focus on the recently enacted sales tax on the following services.[36]

Amusement Services. The comptroller's rule regarding amusement services[37] gives numerous examples of taxable amusement services, ranging from ballet performances to zoos. It notes that amusement services are taxable whether live or recorded, whether purchased individually or by season tickets, and whether spectator or participatory.[38] The rule now specifically discusses both dues and initiation fees for country club memberships,[39] and lists exam-

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also to franchise and other taxes under Title 2 of the Texas Tax Code). *See also* Comptroller Hearing No. 21,983 (June 7, 1988) (taxpayer paid tax voluntarily without receiving deficiency determination or otherwise being assessed, so statute of limitations with respect to assessment was not bar to comptroller's collecting tax; certain of taxpayer's refund claims, however, were barred by statute of limitations).

33. *See* Comptroller Hearing No. 20,955 (May 6, 1988) (taxpayer's sale qualified as single transaction to single purchaser for purposes of meeting occasional sale requirements of 34 TEX. ADMIN. CODE § 3.316(d)(4) (eff. Dec. 24, 1984, 19 Tex. Reg. 6188) notwithstanding fact that transfers took several months to accomplish); Comptroller Hearing No. 19,280 (Dec. 16, 1987) (transfer of assets between sister corporations did not qualify under occasional sale exception for transfers in which ultimate ownership remains "substantially similar"). *See also* 34 TEX. ADMIN. CODE § 3.316(e)(2) (eff. Dec. 24, 1984, 9 Tex. Reg. 6188), and TEX. TAX CODE ANN. § 151.304(b) (Vernon Supp. 1988).

34. Pursuant to 34 TEX. ADMIN. CODE, § 3.294 (eff. Dec. 5, 1984, 9 Tex. Reg. 6017), if a lease is factored or assigned (but not merely as collateral), tax on all remaining lease payments becomes due. *Compare* Comptroller Hearing No. 21,915 (June 10, 1988) (assignment of leases as collateral did not result in acceleration of tax, relying on Bullock v. Citizens National Bank of Waco, 663 S.W.2d 923 (Tex. App.—Austin 1984, no writ)) *with* Comptroller Hearing No. 21,755 (Dec. 1, 1987) (assignment did result in acceleration). *See also* Comptroller Hearing No. 21,396 (Jan. 6, 1987) (discussing rationale underlying acceleration).

35. *See e.g.*, Comptroller Hearing No. 21,248 (Mar. 22, 1988) (comptroller's representative understood situation and offered advice, which was followed by taxpayer; taxpayer's liability nonetheless held not to be directly tied to auditor's advice, since taxpayer could have restructured transactions regardless of auditor's comments); Comptroller Hearing No. 20,612 (Mar. 24, 1988) (taxpayer relied to its detriment on written advice from comptroller and was entitled to relief for periods prior to issuance of letter to industry by comptroller). Both decisions cite Comptroller Decision No. 14,541 (Sept. 20, 1985) which requires a taxpayer to show that (1) it relied on erroneous advice of comptroller employee, (2) the employee had knowledge of the facts sufficient to have enabled him to give correct information, (3) the taxpayer subsequently acted in accordance with advice, and (4) the taxpayer suffered harm by following advice. *Id.*

36. *See* Ohlenforst & Dorrill, Annual Survey of Texas Law: Taxation, 42 SW. L.J. 633, 636-644 (1988) for a description of recent legislative changes affecting sales of services in Texas. This article also describes the regulatory guidance on these taxes that was issued during the months immediately preceding this survey period.

37. 34 TEX. ADMIN. CODE § 3.298 (eff. May 26, 1988, 13 Tex. Reg. 2252).

38. *Id.* § 3.298(a)(7).

39. *Id.* § 3.298(a)(1)(G). *See* 12 Tex. Reg. 3624 for the emergency rule regarding amusement services that first added the specific reference to country clubs.

ples of services that are not amusement services or are exempt from the tax.[40] The sale of ten or fewer admissions during a twelve-month period constitutes an occasional sale if the person selling the admissions does not regularly sell or hold himself out as selling.[41] Although the Tax Code does not exempt from tax a charity event that is co-sponsored by a non-exempt entity,[42] a nonprofit group may hire a for-profit organization to produce an event without losing the exemption.[43]

Credit Reporting Service. The final version of the comptroller's rule on credit reporting services[44] continues to define credit reporting services as broadly as did prior versions of the rule.[45] The rule thus includes "[a]ny written, oral, or other compilation of any credit history or other information bearing on a person's credit worthiness, credit standing, credit capacity, or insurability."[46] The rule specifically includes compilations of medical information.[47]

Data Processing. Significant confusion continues to exist regarding what constitutes taxable data processing. According to the final version of the comptroller's rule on data processing,[48] data processing includes "processing of information for the purpose of compiling and producing records . . . maintaining information, and entering and retrieving information."[49] The rule specifically includes word processing, payroll, and other computerized data and information storage,[50] and it specifically excludes several services, including the preparation of tax returns by accountants.[51] Taxpayers and the comptroller undoubtedly will disagree about the treatment of the vast array of services covered by this rule. The services of a management company, for example, often include a substantial data processing component, and no clear line exists to separate taxable data processing services rendered to the buyer in conjunction with the management services from data processing services that, like secretarial services, the seller uses in providing management services.

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40. 34 TEX. ADMIN. CODE § 3.298(a)(2) (includes hobby clubs and hunting leases).
41. *Id.* § 3.298(a)(3).
42. TEX. TAX CODE ANN. § 151.3101 (Vernon Supp. 1988).
43. 34 TEX. ADMIN. CODE § 3.298(g)(3).
44. 34 TEX. ADMIN. CODE § 3.343 (eff. Mar. 21, 1988, 13 Tex. Reg. 1193).
45. *See* 12 Tex. Reg. 3628 (emergency rule § 3.343, adopted Sept. 30, 1987).
46. 34 TEX. ADMIN. CODE § 3.343(a)(1).
47. *Id.*
48. 34 TEX. ADMIN. CODE § 3.330 (eff. June 16, 1988, 13 Tex. Reg. 2753).
49. *Id.* § 3.330(a).
50. *Id.*
51. *Id.* The rule provides that:

> [d]ata processing does not include the use of a computer by a provider of other services when the computer is used to facilitate the performance of the service or the application of the knowledge of accounting principals [sic] and tax laws, *e.g.*, the use of a computer by a C.P.A. firm, enrolled agents, or bookkeeping firm to produce a financial report, prepare federal income tax, state franchise or sales tax returns, or charges for temporary secretarial personnel who as part of their function use word processing equipment.

Id.

Debt Collection Services. The language enacted by the legislature regarding debt collection,[52] like the language dealing with data processing,[53] requires substantial administrative interpretation. The comptroller defined debt collection services as including any activity, for consideration, to collect or adjust a debt or a claim or to repossess property subject to a "claim."[54] The comptroller defined "claim" as extending to, *inter alia*, an alleged right for money or property, whether the claimed obligation is actual or contingent.[55]

Information Services. The current version of the relevant administrative rule[56] defines information services in language that essentially tracks the statute.[57] The rule specifies that information may be provided by virtually any medium.[58] In an effort to distinguish information services from other taxable services, the rule provides that "[p]rocessing, reformatting or manipulation of data provided by the customer. . ." is data processing and not information services.[59] Unfortunately, the line between data processing and information services remains blurred in practice. Like prior versions of this rule,[60] the final version provides examples of taxable services[61] and of nontaxable services.[62]

Insurance Services. The relevant administrative rule[63] defines each of the six components of insurance services that the statute[64] lists, and provides that any of those activities "performed on behalf of an insurance carrier, its in-

52. TEX. TAX CODE ANN. § 151.0035 (Vernon Supp. 1988).
53. TEX. TAX CODE ANN. § 151.0036(a) (Vernon Supp. 1988).
54. 34 TEX. ADMIN. CODE § 3.354(a)(4).
55. 34 TEX. ADMIN. CODE § 3.354(a)(1) (eff. Mar. 24, 1988, 13 Tex. Reg. 1222). Although the comptroller indicated at one time that debt collection might even include the collection of non-delinquent debts, *e.g.*, by a mortgage company, the adopted rule excludes collection of current credit and real estate accounts. *Id.* § 3.354(b)(2).
56. 34 TEX. ADMIN. CODE § 3.342 (eff. Mar. 25, 1988, 13 Tex. Reg. 1192).
57. *See* TEX. TAX CODE ANN. § 151.0038 (Vernon Supp. 1988).
58. 34 TEX. ADMIN. CODE § 3.342(a)(2). The rule includes information provided "by printed, mimeographed, electronic, or electrical transmission, or by utilizing wires, cable, radio waves, microwaves, satellites, fiber optics, or any other method now in existence or which may be devised." *Id.*
59. *Id.* § 3.342(a)(1) (Lexis and Westlaw are taxable).
60. *See* 12 Tex. Reg. 4769 (§ 3.342 as proposed Dec. 10, 1987).
61. 34 TEX. ADMIN. CODE § 3.342(b). Mailing lists, real estate listings, financial and bond rating reports are among the examples of taxable services.
62. *Id.* § 3.342(d)(1). Information on behalf of a particular client that "is of a proprietary nature to that client and may not be sold to others by the person who gathered or compiled the information," *e.g.*, opinion polls and management consultant reports, is nontaxable. *Id.* Perhaps the emphasis accorded opinion polls in recent elections will prompt Texas legislators or administrators to revisit their decision to exempt such polls from tax. Spokespersons in the comptroller's office have indicated verbally that information services could technically include giving bank account balances to bank customers, although providing such information is not currently considered taxable. A prior version of the rule also listed certain medical records and reports as taxable information services. 12 Tex. Reg. 3627 (emerg. rule § 3.342(e)(4), adopted Sept. 30, 1987). The final rule, however, specifies that sales of information primarily derived from laboratory, medical or exploratory testing or experimentation, including medical test results, are not taxable. 34 TEX. ADMIN. CODE § 3.342(d).
63. 34 TEX. ADMIN. CODE § 3.355 (eff. Mar. 24, 1988, 13 Tex. Reg. 1224).
64. *Id.* § 3.355(b). The statute includes as insurance service "[1] insurance loss or damage appraisal, [2] insurance inspection, [3] insurance investigation, [4] insurance actuarial analysis

sured, its policyholders, or others pertaining to a policy or policies of insurance for monetary fees, dues or other consideration are taxable."[65] The rule defines insurance carrier as including any insurer who is or is required to be licensed or to operate under the provisions of the Texas Insurance Code.[66] The rule excludes certain services from taxable insurance services, including insurance coverage for which a premium is paid or sales commissions paid to an agent.[67] The rule also excludes medical services and certain automobile service contracts.[68]

Real Property Repair and Remodeling. By imposing Texas sales tax on real property repair and remodeling services,[69] the legislature made the line between real and personal property more critical, and required a determination of what constitutes "repair and remodeling" as opposed to maintenance or new construction. The final version of the comptroller's rule[70] regarding these services differs in several respects from prior versions of the rule.

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or research, [5] insurance claims adjustment or claims processing, or [6] insurance loss prevention service." TEX. TAX. CODE ANN. § 151.0039 (Vernon Supp. 1988).

65. 34 TEX. ADMIN. CODE § 3.355(b).

66. *Id.* § 3.355(a)(7).

67. *Id.* § 3.355(c).

68. *Id.*

69. TEX. TAX CODE ANN. § 151.0047 (Vernon Supp. 1988). *See also* TEX. TAX CODE ANN. §§ 151.056 (Vernon Supp. 1988) (lump sum versus separated contract) and 151.058 (Vernon Supp. 1988) (person who performs taxable repair services is consumer of equipment used in performing services, and total amount charged for repair, including charges for labor, materials, overhead and profit is taxable).

70. 34 TEX. ADMIN. CODE § 3.357 (eff. Apr. 4, 1988, 13 Tex. Reg. 1984). *See generally* comments in the preamble to the rule regarding painting. *Id.* The rule as adopted specifies that repainting is presumed to be a restoration or remodeling activity. *Id.* § 3.357(b)(8). Many comments also discussed the allocation of local taxes. Interestingly, the preamble to the final rule (but not to the other service rules) noted that "[u]nless a section addresses a retroactive application, a section is generally effective only from the effective date forward." 13 Tex. Reg. 1984. Although prospective-only application of rules appears logical (*see also* Comptroller Hearing No. 17,587 (May 20, 1987)), the frequency with which administrative rules are "clarified" rather than "revised" makes application of the approach less than clear and makes this explicit statement of policy noteworthy. This rule accords great importance to the contract between buyer and seller. *See also* 34 TEX. ADMIN. CODE § 3.291 (eff. May 16, 1988, 13 Tex. Reg. 2419; as further amended eff. June 13, 1988, 13 Tex. Reg. 3002) which the comptroller modified on an emergency basis as a result of the 1986 legislation (1) to distinguish between contractors who build new structures or repair or remodel residential property and those who repair, remodel or restore commercial property and (2) to provide that dirt and gravel hauling is not taxable. Section 3.357 includes one of several recurring "5% rules." *See* 34 TEX. ADMIN. CODE § 3.357. It provides that the manager's office of a multi-family or other residential complex will only be residential if the space occupied by the office is 5% or less of the total space of the residence. *Id.* § 3.357(a)(8). Facilities subject to the hotel occupancy tax are not considered residential. *Id.* This rule now acknowledges that the distinction between lump-sum and separated contracts is not valid with respect to remodeling or restoration of real property, and it requires that a contract involving both remodeling and new construction be taxed in total unless the charge for new construction labor is separately stated. *Id.* § 3.357(d)(2). Tangible personal property incorporated into real property may either be purchased tax free, or the repairman or remodeler may pay tax on purchases and take credit against tax later collected and remitted on the total sales price. *Id.* § 3.357(b)(4). Separate rules are provided regarding items used in performing repairs, remodeling, or restoration for exempt entities. *Id.* § 3.357(c)(4). The rule further notes that no sales tax is due on the wages or salary paid by an employer to an employee who provides the labor to repair, remodel or restore real property. *Id.* § 3.357(c)(6).

These differences illustrate the difficulty of distinguishing between real property repair and remodeling services which are taxable as of January 1, 1988,[71] real property services which are taxable as of October 1, 1987,[72] and certain nontaxable maintenance services.[73] According to the rule, a contractor is a "person who builds new structures, completes any part of an uncompleted new structure which is an improvement to real property, or makes an improvement to residential property."[74] "Labor" includes all components of a transaction or contract directly related to the described services, except those attributable to materials incorporated into the realty.[75] Labor includes even unrelated components, such as engineering and architectural charges unless such charges are separately stated to the customer.[76]

Maintenance generally includes necessary, scheduled periodic work on operational and functioning improvements to real property, whereas new construction includes new improvements.[77] New construction specifically includes the additional completed floors of or new area added to an existing structure.[78] These definitions again highlight the practical difficulties in administering the new law: does a complete gutting and rebuilding constitute new construction or an improvement?

The definition of remodeling only partially helps answer this and similar questions. The rule states that making over or rebuilding real property or structures "in a similar but different way" constitutes remodeling.[79] On the other hand, the rule defines "repair" as mending or bringing back "as near as can be to its original working order real property which was broken, damaged, or defective,"[80] and it defines "restoration" as bringing "back as near as can be to its original condition real property which is still functional but which has faded, declined or deteriorated."[81]

Charges for labor to maintain real property are not taxable.[82] The comptroller presumes that services provided only as needed, and not pursuant to a contract, are for repair or restoration.[83] The service provider, however, may accept an exemption certificate stating that the labor is for the purpose of maintenance rather than repair or restoration and that the customer will be liable for any additional tax due in the event that it is determined that the service provider performed repairs rather than maintenance.[84]

Real Property Services. As the preceding paragraph points out, the lines of

71. TEX. TAX CODE ANN. § 151.0101(a)(13) (Vernon Supp. 1988).
72. *Id.* § 151.0101(a)(11).
73. *See* 34 TEX. ADMIN. CODE § 3.357(c)(2).
74. *Id.* § 3.357(a)(1).
75. *Id.* § 3.357(a)(2).
76. *Id.*
77. *Id.* § 3.357(a)(3).
78. *Id.* § 3.357(a)(4).
79. *Id.* § 3.357(a)(6).
80. *Id.* § 3.357(a)(7).
81. *Id.* § 3.357(a)(9).
82. *Id.* § 3.357(b)(1) and (c)(2).
83. *Id.*
84. *Id.*

demarcation among the various property services are far from clear. The final version of the applicable rule[85] reflects efforts to define more clearly the meaning of real property services.[86] The final version of the rule also addresses more specifically than did earlier versions the application of the tax to property management companies.[87] According to the rule, such companies need not collect tax on taxable services provided by their employees as part of the overall management and operation of an apartment complex, office building or other real property if the value of the taxable service is insignificant.[88]

Security Services. Statutory language[89] and regulatory interpretation[90] provide that security services include any service provided within the scope of the required license by an investigations company, guard company, alarm system company, or similar company. The comptroller, however, has indicated informally that he does not intend to tax ordinary delivery services even if such services are made by a licensed security company. Services by an employee in the regular course and scope of his duties for his employer, for which the employer pays the employee his regular wages or salary, are not taxable.[91] This rule, however, fails to include a definition of employer-employee.

Sales for Resale. Tax Code Section 151.302 provides that a purchaser who buys property or services and who complies with the resale exemption requirements is not required to pay sales tax on his acquisition of the taxable items.[92] The comptroller's regulations provide guidance for determining what constitutes a resale of services.[93] These rules allow a seller to provide a resale certificate to its suppliers of tangible personal property if (1) the seller uses the property in providing services, and (2) the seller transfers to its customers the care, custody and control of the tangible personal property.[94] Thus, for example, a seller of data processing services who uses magnetic tapes and transfers the tapes to its customers may qualify for exemption from tax on its acquisition of the tapes. A seller may qualify for a resale

85. 34 TEX. ADMIN. CODE § 3.356 (eff. Apr. 25, 1988, 13 Tex. Reg. 2043). *See also*, 13 Tex. Reg. 5537 (1988) (amending 34 TEX. ADMIN. CODE § 3.356 regarding garbage and solid waste services, cemetery upkeep, and property managers).

86. 34 TEX. ADMIN. CODE § 3.356(a)(2)-(3).

87. *See id.* § 3.356(m).

88. *Id.* § 3.357(c).

89. TEX. TAX CODE ANN. § 151.0075 (Vernon Supp. 1988).

90. 34 TEX. ADMIN. CODE § 3.333 (eff. Mar. 24, 1988, 13 Tex. Reg. 1221).

91. *Id.* § 3.333(c).

92. TEX. TAX CODE ANN. § 151.302 (Vernon Supp. 1988).

93. *See* 34 TEX. ADMIN. CODE § 3.285 (resale certificate); *id.* § 3.298(f) (amusement services). *See also id.* § 3.298(d) (providing for the circumstances in which travel agency must pay tax on tickets it acquires); *id.* § 3.343(c) (credit reporting services); *id.* § 3.330(c) (data processing); *id.* § 3.354(c) (debt collection services); *id.* § 3.342(e) (information services); *id.* § 3.355(h) (insurance services); *id.* § 3.357(d) (real property repair and remodeling); *id.* § 3.356(d) (real property services—resale certificate allowed if tangible personal property will be incorporated into customer realty); *id.* § 3.333(f) (security services).

94. *See supra* note 93.

exemption for a service if the buyer intends (1) to transfer the service as "an integral part" of taxable services, or (2) to incorporate the service into tangible personal property to be resold.[95] A service is an integral part of another service if it "is essential to the performance of the taxable service and without which the service could not be rendered."[96]

Unrelated Services. One of the most troubling problems in determining what is taxable arises when taxable services are sold in conjunction with nontaxable services. On such mixed sales, it is sometimes difficult to determine which services are taxable and which are not. Moreover, it is often even more difficult to allocate the costs properly among services. Because it is generally in both the buyer's and the seller's best interest to allocate only minimal charges to the taxable part of a mixed sale, it is impractical to rely on arms-length negotiation to produce a proper allocation. The comptroller has therefore ruled that if a nontaxable "unrelated service" and a taxable service are provided for a single charge, and the taxable services represent more than five percent of the total charge, the total charge is presumed taxable.[97] However, this presumption may be overcome by separately stating a reasonable charge for taxable services provided to the customer. If a seller separately states to the customer a reasonable charge for taxable services, then a service that is (1) not a taxable service, (2) of a type that is commonly provided on a stand alone basis, and (3) the performance of which is distinct and identifiable, need not be taxed even though it is sold together with the taxable service.[98] Charges for services or expenses (*e.g.*, hotel rooms and telephone calls) directly related to an incurred while providing a taxable service are nonetheless taxable.[99] The seller must maintain books supporting the charge for taxable services based on the cost of providing the service or on a comparison to the normal charge for the services if provided alone.[100]

Although the insurance service rule contains the language summarized in the preceding paragraph, the rule for insurance services differs somewhat from the other service rules because it further provides that if an insurance service is performed "as a part of a nontaxable service and the primary purpose for purchasing the nontaxable service is not insurance related, no part of the fee or charge is taxable."[101] For example, an appraisal required by a lender as a condition of extending credit is not a taxable insurance service because its primary purpose is to finance a loan, even if the appraisal is also used as the basis for establishing minimum property insurance required by

95. *See supra* note 93.

96. *See supra* note 93, but note that §§ 3.357(d) and 3.356(d) do not include the same language on transfers of taxable services.

97. *Id. See* 34 TEX. ADMIN. CODE § 3.343(d) (credit reporting services); *id.* § 3.330(d) (data processing); *id.* § 3.354(e) (debt collection services); *id.* § 3.342(f) (information services); *id.* § 3.355(i) (insurance services); *id.* § 3.357(h) (real property repair and remodeling); *id.* § 3.356(i) (real property services); *id.* § 3.333(g) (security services). *But see id.* § 3.298 (amusement services) (does not include the same general rule).

98. *See supra* note 97.

99. *See supra* note 97.

100. *See supra* note 97.

101. 34 TEX. ADMIN. CODE § 3.355(f).

the lender.[102]

Multistate and Other Location of Sale Issues. The difficulty of determining where a sale occurs makes the administration of the new services taxes more complex. If a California data processing company provides services to Texas customers, has a California sale or a Texas sale occurred? Does the answer differ if the data processing input consists of compiling a list of purchases of goods in Nevada? What if the information is transmitted over phone lines in Arizona? In a valiant effort to provide some sense of certainty for taxpayers, the comptroller has promulgated standards for determining the location of sales.[103] These rules are necessary not only to avoid placing Texas companies at a competitive disadvantage with companies from other states (a result that would occur if the location of the service provider were the only test),[104] but also to determine which local taxing jurisdiction is entitled to impose tax.[105]

The multistate rules are critical because they determine whether, and to what extent, purchases by multistate entities will be subject to Texas sales tax. A multistate customer purchasing services for the benefit of both a Texas and non-Texas location is responsible for allocating and paying tax on that portion that benefits the Texas location.[106] This procedure differs from general practice in that it requires the buyer to self-assess and remit the tax. Tax is not due to the extent the services are used outside of Texas. The buyer may use "any reasonable method" supported by business records to determine which services are for the benefit of Texas locations and therefore taxable.[107] To the extent that a buyer uses a service to support a "separate, identifiable segment" of its business, other than the general administration/operation of the business, the service is presumed to be used at the location where the buyer conducts that part of the business.[108] To the extent service use cannot be assigned to an identifiable segment, the rules presume it is used at the customer's principal place of business, *i.e.*, the place from which the customer directs or manages the trade or business.[109]

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102. *Id.*

103. *See* 34 TEX. ADMIN. CODE § 3.343(f) (credit reporting services); *id.* § 3.330(f) (data processing); *id.* § 3.354(g) (debt collection services); *id.* § 3.342(h) (information services); *id.* § 3.355(j) (insurance services). No multistate provisions exist in the rules regarding amusement services, real property and remodeling services, real property services, or security services.

104. The legislature did not intend to tax services used outside Texas, even if a Texas seller provided the services. The legislature intended to tax services used in Texas, even if a non-Texas seller provided the services. *See* TEX. TAX CODE ANN. § 151.330(e)-(f) (Vernon Supp. 1988).

105. Determining which city, MTA or county sales taxes apply will determine whether the total tax will be six percent of sale proceeds, eight percent, or fall between these two percentages.

106. *See supra* note 103.

107. *See supra* note 103.

108. *See supra* note 103.

109. *Id. See* 34 TEX. ADMIN. CODE § 3.343(g) (credit reporting services); *id.* § 3.330(g) (data processing); *id.* § 3.342(i) (information services). *But see id.* § 3.298(j) (amusement services; local tax allocated to city, county and/or MTA/CTD where amusement event occurred).

For sales of many services, city, MTA or county taxes are due to the local unit if the seller has only one place of business, "the location where clients request service."[110] These rules provide that if service is ordered from one location, but provided from another, tax is due where service is provided.[111] If the seller is outside the boundary of a local taxing jurisdiction, but the buyer is inside such a jurisdiction, use tax is due.[112] The seller collects the tax if it has representation in the jurisdiction under the applicable administrative rule; otherwise, the buyer must pay the tax.[113] An in-state customer purchasing services for the benefit of more than one local taxing jurisdiction must allocate the extent of the benefit of such services for each jurisdiction, and a multistate customer purchasing services for the benefit of both in and out-of-state locations is responsible for paying local tax.[114] This allocation process may be burdensome for many buyers, because many businesses do not typically organize data with respect to services on a state-by-state basis or on a city-by-city basis.

Different rules from those outlined above apply to debt collection services,[115] insurance services,[116] real property repair and remodeling services,[117] real property services,[118] and security services.[119] Local taxes apply to these services in the same way that they apply to tangible personal property.[120] Service providers generally collect local tax if their place of business is within the local unit, regardless of the location at which service is actually provided.[121] MTA and CTD taxes do not apply to services provided outside the boundaries of transit areas.[122] The seller is responsible for collecting use tax on services provided to a customer within a local unit if the seller's place of business is outside such a jurisdiction.[123]

According to the administrative rule on amusement services, if an event occurs in Texas, the amusement service is in Texas and is taxable.[124] Use tax is due on an out-of-state sale to an event that will take place in Texas.[125] If no ticket or other physical evidence of admission is involved, the rule considers admission to be at the seller's place of business.[126] Local tax is allocated to the location at which the amusement event occurred.[127]

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110. *See supra* note 109.
111. *See supra* note 109.
112. *See supra* note 109.
113. *See supra* note 109.
114. *See supra* notes 103 and 109.
115. *Id.* § 3.354(h).
116. *Id.* § 3.355(k).
117. *Id.* § 3.357(e).
118. *Id.* § 3.356(k).
119. *Id.* § 3.333(k).
120. *See supra* notes 115-119.
121. *Id.*
122. *Id. See also* Comptroller Hearing Nos. 22,681 (Aug. 19, 1988) and 21,211 (May 26, 1988) which discuss application of the MTA tax.
123. *See supra* notes 115-119.
124. 34 TEX. ADMIN. CODE § 3.298(e)(1).
125. *Id.* § 3.298(e)(2).
126. *Id.* § 3.298(e)(3).
127. *Id.* § 3.298(j).

Exemptions and Grandfathering. As last year's survey article pointed out,[128] the 1987 legislature enacted two distinct grandfathering provisions[129] and one related-company exemption with respect to sales taxes.[130] Many of the issues raised with respect to these provisions remain unanswered. On occasion, comptroller's representatives have evinced a willingness to interpret the applicable rules broadly, *e.g.*, to allow price reductions despite the regulatory provision that no price changes are permissible,[131] but they have also interpreted some provisions very narrowly, *e.g.*, by asserting that the exemption for affiliated "entities" may apply only to corporations.[132] With respect to this latter interpretation, it appears that legislative action may be necessary to confirm an exemption for sales among related partners or other non-corporate entities.

Another issue that remains somewhat clouded is the status of contracts that fail to specify a definite amount of goods or a specific price. The rule which provides that such contracts are not eligible for grandfather status[133] seems much more restrictive than the statute, perhaps impermissibly so, and probably more restrictive than necessary for policy reasons. Some companies may attempt to abuse the grandfather rule by increasing the amount of goods or services after the prior contract cut-off date. However, other parties may have operated for a number of years with a contract for services "as needed," and continue to operate—at the same levels as prior to July 1987—on that basis. The comptroller would have a difficult time justifying a denial of prior contract status in such cases, and, despite the restrictive language in the rule, the comptroller has not clearly indicated that he will do so. The comptroller proposed or adopted new rules on other issues as well, including a rule regarding the definition of "engaged in business" in Texas for sales tax purposes.[134]

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128. *See* Ohlenforst & Dorrill, *Annual Survey of Texas Law: Taxation*, 42 SW. L.J. 633, 640-41 (1988) for a description of the recent legislative changes affecting services sold in Texas. This article describes the regulatory guidance on services taxes that the comptroller issued during the months immediately preceding this survey period.

129. *See supra* note 21.

130. TEX. TAX CODE ANN. § 151.346 (Vernon Supp. 1988).

131. *See* 34 TEX. ADMIN. CODE § 3.319 (which includes form for claiming prior contract exemption). The policy underlying the restrictions in the rule is apparently to prevent taxpayers from artificially expanding a contract in order to increase the amount or types of services that are exempt under the grandfather rule; a decrease in price or the extension or renewal of a contract that, by its original terms, extends beyond July 1, 1990 does not violate this policy. Consistent with this observation, a spokesperson in the Comptroller's office indicated informally that price decreases and/or renewals for periods after July 1, 1990 will not adversely impact qualification for grandfathering.

132. *See* TEX. TAX CODE ANN. § 151.346 (Vernon Supp. 1989). The language of the statutory exemption is broad enough to include noncorporate entities.

133. 34 TEX. ADMIN. CODE at § 3.319(a).

134. *See* 34 TEX. ADMIN. CODE § 3.286 (eff. Aug. 25, 1988, 13 Tex. Reg. 3989). As amended, the rule provides that advertising will be considered to be intended for Texas if 75% of the consumers are located in Texas. This mechanical test should present some interesting issues, *e.g.*, where are traveling radio listeners located? How is the percentage determined? The rule specifically provides that a non-Texas retailer not otherwise engaged in business in Texas will not be treated as engaged in business here "by merely placing a request for financing, telecommunications, banking, marketing or debt collection services at an *out-of-state location* of a service provider even though the service is performed in whole or in part in Texas."

II. FRANCHISE TAX

A. Calculation of Taxable Capital

Although Texas courts did not render as many significant franchise tax decisions as in the last survey period, several recent decisions merit discussion. In *State v. Shell Oil Co.*[135] the Austin court of appeals held that the taxpayer, an oil drilling company, was entitled to exclude from surplus its contra-asset account for amortization of unproven leaseholds.[136] In accordance with generally accepted accounting principles ("GAAP"), the taxpayer had utilized the successful efforts method of accounting by which it amortized, based on experience, a portion of the costs of the nonproducing leaseholds. The district court found that the company based the accounts on reasonable estimates which accurately reflected the corporation's financial condition.[137] The court ruled, therefore, that the company could exclude the contra-asset account from surplus.[138] The Austin court of appeals agreed, stating that the comptroller's long-standing policy of not reducing surplus by estimated writedowns, no matter how accurate, was contrary to the franchise tax statute, which contemplated that surplus be determined upon the true financial condition of the corporation.[139] It is noteworthy that the 1987 legislation providing that surplus includes contingent or estimated liabilities or losses, or writedown of assets, probably does not limit a taxpayer's ability to amortize unproven leaseholds because the legislation provides an exception for, among other items, contra-asset accounts for amortization.[140]

The Austin court of appeals in *Southern Clay Products, Inc. v. Bullock*[141] held that an acquired corporation (the "taxpayer") whose new parent corporation required it to increase the book value of certain of its assets to reflect their takeover value[142] rather than their historical cost must value such assets for franchise tax purposes based on the higher takeover value.[143] The taxpayer continued to use the historical cost of these assets on its working

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Id. § 3.286(a)(1)(G)(ii) (emphasis added). Out-of-state sellers must identify tax collected as Texas tax.

135. 747 S.W.2d 54 (Tex. App.—Austin 1988, no writ).

136. *Id.* at 56. The rationale in the *Shell* case is similar to that provided in State v. Sun Refining & Marketing, Inc., 740 S.W.2d 552 (Tex. App.—Austin 1987, writ denied).

137. 747 S.W.2d at 55.

138. *Id.* at 57.

139. *Id.* The court noted that the comptroller's position is in conflict with, among other cases, Huey & Philip Hardware Co. v. Shepperd, 251 S.W.2d 515 (Tex. 1952), in which the Texas Supreme Court held that a reserve for bad debts can be excluded from surplus.

140. TEX. TAX CODE ANN. § 171.109(i)(2) (Vernon Supp. 1988). The statute now provides that all oil and gas exploration activities must be reported pursuant to either the successful efforts or the full cost method of accounting. TEX. TAX CODE ANN. § 171.109(g) (Vernon Supp. 1988).

141. 753 S.W.2d 781 (Tex. App.—Austin 1988, no writ).

142. The takeover value of a corporation's assets equals the fair market value of such assets as determined by allocating to such assets the consideration paid for the corporation by the new owner. This method of accounting is often referred to as "push-down accounting." *See* Comptroller Hearing No. 20,278 (May 16, 1987) (discussion of push-down accounting).

143. 753 S.W.2d at 783-84.

papers, but used the takeover value for such assets on its general ledger.[144] The comptroller disregarded the work papers in determining the taxpayer's franchise tax liability because its administrative rule[145] required corporations to determine their franchise tax liability based on information contained in the corporation's general ledger. The court ruled that this rule was not arbitrary and capricious and that the taxpayer should have complied with the rule.[146]

The taxpayer in *Southern Clay* argued that the rule violated the equal and uniform taxation clause in the Texas Constitution because similarly-situated corporations which keep their general ledger based on historical cost, rather than takeover values, would pay lower franchise taxes than the taxpayer.[147] The court rejected this argument because the taxpayer did not show that the challenged rule had been "applied to a large class of other individuals" and was not therefore inherently discriminatory.[148] This decision, however, apparently leaves open the possibility that the comptroller's policy regarding the valuation of assets at their takeover value could be challenged successfully if a taxpayer were to present sufficient evidence of the discriminatory application of the policy to a large class of other individuals.[149]

In *Sunoco Terminals, Inc. v. Bullock*[150] the appeals court held that a newly formed corporation can be required to include in its taxable capital the assets it received from a related corporation even though the transferor corporation also included such assets in its taxable capital for the same year.[151] Both companies included the transferred assets in their tax bases for approximately three months because a newly formed corporation pays tax for its first report period based on its capital at the end of such period, thereby including the transferred assets in its capital. An established corporation, however, pays franchise tax in advance and bases such advance payment in its capital for the fiscal year generally ending *before* the transfer of the assets to the related corporation.[152] The court ruled that the franchise tax is a tax for the privilege of doing business in Texas and is not a tax on

144. If the taxpayer had kept two general ledgers, one for historical cost and one for takeover value, as it did for one fiscal year, it would not have been required to use the takeover values in computing its franchise tax. *Id.* at 782.

145. 34 TEX. ADMIN. CODE § 3.391 (repealed April 15, 1988). The comptroller substantially revised this rule in 1988 to reflect the amendments to the franchise tax statutes in 1987. 34 TEX. ADMIN. CODE § 3.391 (eff. June 28, 1988, 13 Tex. Reg. 2970).

146. 753 S.W.2d at 783. 34 TEX. ADMIN. CODE § 3.391(c)(3) (1988) (eff. June 28, 1988, 13 Tex. Reg. 2970) requires push-down accounting if the majority of a corporation's voting stock is acquired through a purchase.

147. This argument is essentially the same as the prevailing argument made by the taxpayer in Bullock v. Sage Energy Co., 728 S.W.2d 465 (Tex. App.—Austin 1987, writ ref'd n.r.e.). *See* Ohlenforst & Dorrill, *Annual Survey of Texas Law: Taxation*, 42 SW. L.J. 631, 644 (1988) (discussing *Sage*).

148. 753 S.W.2d at 784.

149. *But see* Comptroller Hearing No. 22,281 (April 21, 1988) (concluding that comptroller's policy with respect to push-down accounting is constitutional because taxpayers are not required to employ push-down accounting on their books).

150. 756 S.W.2d 418 (Tex. App.—Austin 1988, no writ).

151. *Id.* at 420.

152. *See* TEX. TAX CODE ANN. §§ 171.151-171.153 (Vernon Supp. 1988). Because the first two (and often three) report periods are based on the first year's capital of a new corpora-

capital; therefore, Texas can require related corporations to pay franchise tax based on the same capital.[153]

The comptroller issued several noteworthy decisions with respect to determination of capital. In Decision 20,999[154] the comptroller ruled that push-down accounting should be used not only when it results in an increase in value of the purchased corporation's assets, but also when it results in a decrease in the value of the purchased corporation's assets.[155] This reduction in value can occur if the purchase price allocated to an asset is less than the taxpayer's basis in such asset. The comptroller stated that the historical cost method of determining capital should not be employed when the facts, such as a recent purchase of the taxpayer's stock, demonstrate that such a method is no longer appropriate.[156]

In Decision 22,077[157] the comptroller treated an advance between related parties as debt even though the interest rate on the note was zero and the debtor repaid little or none of the advance in the initial years of the loan.[158] While noting that the case presented a close question, the comptroller was swayed by evidence demonstrating that the borrower could have obtained a loan from an unrelated party and that the lender had a valid business reason for charging no interest.[159] Similarly, the comptroller in Decision 21,735[160] treated an advance between related parties as a debt although the transaction included no interest, no written note, and no collateral.[161] The comptroller stated that the lack of interest usually weighs heavily against a finding that a valid debt exists but concluded that the lender in this case had made a deliberate decision not to charge interest because employees of the borrower would benefit by the lender's not charging interest.[162]

In Decision 22,747[163] the comptroller ruled that preferred stock issued by the taxpayer in bankruptcy must be included in the taxpayer's stated capital.[164] The taxpayer asserted that Accounting Principles Board Opinion No. 16 requires the acquiring entity's books to reflect the stock as a liability. The comptroller responded that because the taxpayer was not the acquiring en-

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tion, the franchise tax statute offers significant planning opportunities if contributions to a new corporation can be deferred until after its first accounting year.

153. 756 S.W.2d at 420.

154. Comptroller Hearing No. 20,999 (March 18, 1988).

155. *Id.*

156. *Id.* The comptroller reached the same conclusion with respect to "negative push-down accounting" in Comptroller Hearing No. 21,447 (Feb. 18, 1988).

157. Comptroller Hearing No. 22,077 (May 6, 1988).

158. *Id.*

159. *Id.* For an extensive discussion of the factors used by the comptroller in distinguishing debt from equity, *see* Comptroller Hearing Nos. 20,956 and 20,957 (Aug. 18, 1987).

160. Comptroller Hearing No. 21,735 (May 10, 1988). In Comptroller Hearing Nos. 20,956 and 20,957 the comptroller may have been influenced by a 14 percent minority ownership in the borrower. The minority ownership is significant because the parent corporation of the borrower would be less willing to make a loan to the subsidiary if the subsidiary possibly could not repay the debt.

161. Comptroller Hearing No. 21,735 (May 10, 1988).

162. *Id.*

163. Comptroller Hearing No. 22,747 (July 8, 1988).

164. *Id.*

tity, the Opinion did not control.[165]

In a reversal of longstanding policy, the comptroller's office has advised taxpayers orally and in ruling letters that a negative balance in surplus can be offset against stated capital.[166] This policy change should be especially important to corporations required to maintain high stated capital.[167] As a result, taxpayers should file refund claims for any open years for which this policy change would result in lower taxes than were reported and paid.

B. Allocation of Capital

In Decision 21,221[168] the comptroller ruled that gross receipts received by a taxpayer from a grantor trust (i.e., a trust ignored for federal income tax purposes) should be treated as distributions from the trust rather than as attributable to the situs of the underlying trust assets.[169] The grantor trust in this decision held a 99.99 percent interest as a general partner in a royalty partnership. Although the trustee was located in Texas, the taxpayer argued that its gross receipts from the trust should be allocated based on the partnership's principal place of business. The comptroller conceded the reasonableness of the taxpayer's position, but concluded that he could not ignore the existence of the grantor trust for franchise tax purposes.[170]

In Decision 20,540[171] the comptroller held that proceeds from the sale of crude oil that the taxpayer delivered to a common carrier pipeline in Louisiana and then transported to Texas are Texas receipts.[172] The taxpayer asserted that it never delivered the oil to Texas because the purchaser took possession of the oil in Louisiana. The comptroller disagreed, and allocated the receipts to Texas, reasoning that the taxpayer ultimately shipped the oil to the buyer in Texas.[173] The comptroller claimed that constructive conditions of the delivery, such as FOB point, control and title, are irrelevant in determining whether receipts are allocable to Texas.[174]

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165. *Id. See* 34 TEX. ADMIN. CODE § 3.404 (eff. June 28, 1988, 13 Tex. Reg. 2971) (stated capital).

166. It is not clear whether the comptroller will amend 34 TEX. ADMIN. CODE § 3.405 (eff. June 28, 1988, 13 Tex. Reg. 2972) (defining surplus) to reflect this change in policy. The Texas Corporation Franchise Tax Report (last revised December 1986) states that if surplus is a negative amount, it cannot be subtracted from stated capital.

167. Consider, for example, a corporation responsible for paying Texas franchise tax with $10 million of stated capital and $10 million of surplus. Assume that all of the corporation's gross receipts are allocable to Texas. Under prior policy, the corporation would owe $67,000 of franchise tax each year; under current policy, the corporation would owe only $150 of tax each year. *See* TEX. TAX CODE ANN. § 171.002 (Vernon Supp. 1989).

168. Comptroller Hearing No. 21,221 (Oct. 2, 1987).

169. *Id.*

170. *Id.*

171. Comptroller Hearing No. 20,540 (Mar. 29, 1988).

172. *Id.*

173. *See* TEX. TAX CODE ANN. § 171.104 (Vernon 1982) (stating that FOB point or conditions of sale should not be considered in allocating gross receipts).

174. *Id.*

C. *Liability for Tax—Doing Business in Texas*

Recent comptroller's decisions confirm that minimal Texas activity can cause a corporation to be "doing business" in the state for franchise tax purposes. In Decision 22,840[175] the comptroller ruled that a corporation establishes a constitutional nexus with Texas by making deliveries into Texas by common carrier and by having two representatives that periodically visit Texas to remind customers that the taxpayer will quote prices on its products and to thank customers for their past business, even though the representatives take no orders while in the state.[176] The comptroller stated that the fact that the representatives live outside of Texas is unimportant.[177]

Decision 22,440[178] concluded that a corporation which had no offices or employees in Texas, but which had a single representative who spent less than twenty percent of his working time in Texas, was doing business in Texas.[179] The representative distributed brochures in the state but did not solicit or take orders. Because the representative's job was to promote sales in Texas, the comptroller ruled that the corporation had a constitutional nexus with Texas.[180]

According to Decision 21,223,[181] a corporation that submitted an application for, but was denied, a Certificate of Withdrawal from Texas was responsible for the payment of Texas franchise tax.[182] The comptroller ruled that the corporation was responsible for the tax irrespective of whether the corporation had a constitutional nexus with Texas.[183] The comptroller also ruled that he did not have jurisdiction to determine whether the Secretary of State correctly refused the Certificate of Withdrawal.[184]

D. *Consequences of Failure to Pay*

The Corpus Christi court of appeals held in *M & M Construction Co. v.*

175. Comptroller Hearing No. 22,840 (July 15, 1988).

176. *Id.*

177. *Id.* An important facet of the decision concerns the comptroller's statement that the date of the amendment of 34 TEX. ADMIN. CODE § 3.406 (eff. Jan. 9, 1986, 10 Tex. Reg. 4950) (subsequently amended with minor changes on December 28, 1987, 12 Tex. Reg. 4702), the rule setting forth the standard for determining whether a corporation is doing business in Texas, is significant. The comptroller implied that the amendment was a change in the comptroller's test for what constitutes doing business in Texas rather than a mere clarification of the previous rule. In many tax controversies, the Tax Division of the Comptroller's office had taken the position that the amended rule was a mere clarification of the prior rule. *See id.* (preamble to amendment implies that at least certain provisions in amended rule are clarifications of prior rule).

178. Comptroller Hearing No. 22,440 (Apr. 19, 1988).

179. *Id.*

180. *Id. See* 34 TEX. ADMIN. CODE § 3.406(c)(4) (eff. Dec. 28, 1987, 12 Tex. Reg. 4702) (solicitation); Tyler Pipe Industries, Inc. v. Washington State Department of Revenue, 107 S. Ct. 2810, 97 L. Ed.2d 199 (1987) (defining nexus in the context of establishing and maintaining a sales market).

181. Comptroller Hearing No. 21,223 (Dec. 21, 1987).

182. *Id.*

183. *Id.* Corporations are responsible for paying Texas franchise tax if they are chartered in Texas, qualified to do business in Texas, or are doing business in Texas. TEX. TAX CODE ANN. § 171.001 (Vernon 1982).

184. Comptroller Hearing No. 21,223 (Dec. 21, 1987).

Great American Insurance Co.[185] that a corporation which lost its corporate charter for failure to pay franchise taxes should be allowed a reasonable opportunity to cure its lack of capacity either by paying its delinquent taxes or by bringing suit in the shareholders' names.[186] The district court had dismissed with prejudice the taxpayer's suit after it had forfeited its corporate charter for failure to pay franchise taxes.[187] The court reversed the dismissal, stating that the purpose of the statute in forfeiting charters of corporations that failed to pay franchise taxes is to encourage the payment of taxes and not to prohibit causes of action.[188]

E. Administrative Developments

The significant changes that the 1987 legislature[189] made to the franchise tax precipitated the revision of virtually all of the most significant comptroller's rules concerning the franchise tax and the issuance of additional new rules. The newly revised franchise tax rules include numerous definitions and directions for determining Texas franchise tax.

Because taxpayers with a surplus of more than one million dollars are now required to use generally accepted accounting principles for franchise tax purposes,[190] the comptroller has provided a definition of GAAP.[191] GAAP generally means the broad accounting rules formally adopted by the American Institute of Certified Public Accounts ("AICPA") or its designees through publication of a statement, interpretation, opinion or research bulletin.[192] If no such effective, published pronouncement exists, formal acceptance may be a written interpretation of an AICPA committee or its designee.[193] If no such written interpretation exists, formal acceptance may be through accepted industry accounting practices, publication of the SEC or of regulatory agencies, or "any other means which may be shown by the taxpayer to indicate formal acceptance."[194]

Whether a taxpayer has one million dollars of surplus, and is therefore required to use GAAP, depends on the accounting method used in the last federal return originally due before the franchise tax report, unless another

185. 747 S.W.2d 552 (Tex. App.—Corpus Christi 1988, no writ).
186. *Id.* at 555.
187. *Id.* at 554.
188. *Id.* at 554, *citing* Bluebonnet Farms, Inc. v. Gibraltar Savings Association, 618 S.W.2d 81, 83 (Tex. Civ. App.—Houston [1st Dist.] 1981, writ ref'd n.r.e.).
189. *See* Ohlenforst & Dorrill, *Annual Survey of Texas Law: Taxation*, 42 SW. L.J. 633, 648 (1988).
190. TEX. TAX CODE ANN. § 171.109(c) (Vernon Supp. 1988).
191. 34 TEX. ADMIN. CODE § 3.391(c)(1) (eff. June 28, 1988, 13 Tex. Reg. 2970). By its terms, the rule applies to franchise tax reports originally due on or after January 1, 1988. This rule, which includes subject matter that was formerly in 34 TEX. ADMIN. CODE § 3.408, *repealed* Jan. 1, 1988, 13 Tex. Reg. 165, is an entirely new rule, and it replaces the former 34 TEX. ADMIN. CODE § 3.391 (repealed 1987), which had required a corporate taxpayer to compute tax based on its financial condition as shown in its "books and records of account." Previous versions of the rule had also required corporations to base franchise tax on their books and records. *See, e.g., id.* § 3.391(b)(1).
192. *Id.* § 3.391(c)(1).
193. *Id.*
194. 34 TEX. ADMIN. CODE § 3.391(d)(2).

method is specifically required by the Tax Code.[195] Even if the rule allows a corporation to use the federal income tax method, the corporation must account for income exempt for federal income tax purposes in determining surplus and gross receipts.[196] The GAAP reporting method need not conform to financial reports, although the rule presumes accurate factual assertions in published financial statements.[197] When filing a franchise tax report, a corporation must use the same accounting method for both gross receipts and surplus, using either the GAAP or the federal income tax method.[198] A change in accounting will be recognized only if it corrects an "accounting error," which, as defined, can result from a mistake in math, in the application of accounting principles, or from an oversight or unintentional misuse of facts that existed on the date upon which the report is based.[199]

Surplus. A new rule promulgated in June 1988 provides guidance regarding calculating surplus for franchise tax purposes.[200] The rule defines a number of key terms. An unrealized, estimate or contingent loss or obligation includes an appropriation of retained earnings for any purpose.[201] The term also includes an account to record a reasonably anticipated loss or obligation which has been reasonably estimated as of the date on which the tax is based.[202] The rule provides that surplus must be based on a corporation's accounting period ending in the calender year ending immediately prior to the reporting period at issue, or, if no accounting period ends in the previous calender year, as of December 31 of the previous calendar year.[203]

A write-down of assets is any "reduction or offset of the cost of an asset by valuation, allowance, reserve or contra-asset account, or through direct write-off of the asset."[204] A write-down of assets does not include a direct write-off of all or a portion of the cost of the asset to reflect a permanent decline in the asset's value due to a specifically identifiable event.[205] The taxpayer may exclude this latter type of write-off. The rule also defines depletion, depreciation and amortization, exclusive of goodwill, and further defines tax effect and investee.[206]

The taxpayer must use the equity method of accounting for partnerships or joint ventures.[207] The final rule, unlike the proposed version,[208] allows a

195. *Id.* § 3.391(d)(3).
196. *Id.* § 3.391(c)(2).
197. *Id.* § 3.391(b)(1) and (4).
198. *Id.* § 3.391(b)(5).
199. 34 TEX. ADMIN. CODE § 3.405. The rule's provisions apply to franchise tax reports originally due on or after January 1, 1988. *Id.* § 3.405(a). This rule replaces former Section 3.405 (as amended in 1977), which was repealed. *See* Comptroller of Pub. Accounts, 13 Tex. Reg. 1545 (1988). The new rule includes some elements of a draft version of Section 3.405 which was circulated, but not officially proposed, in 1985.
200. 34 TEX. ADMIN. CODE § 3.405(c)(1).
201. *Id.*
202. *Id.* § 3.405(b).
203. *Id.* § 3.405(c)(2).
204. *Id.* § 3.405(e)(9).
205. *Id.*
206. *Id.* § 3.405(d)(1)(B).
207. *See* 13 Tex. Reg. 1529.

corporation with less than one million dollars in surplus to report its oil and gas exploration and production activities using the same method used for federal income tax purposes; other corporations must use the successful efforts or full cost method.[209] The rule also provides specific guidance with respect to intercompany tax accounts. The rule excludes a liability of one member to another in a consolidated group from that member's surplus only if the related receivable is included in the second member's surplus.[210]

Surplus includes: amortization of goodwill resulting from the acquisition of an ownership interest in an investee or subsidiary corporation; deferred investment tax credit; income tax accrued other than for actual liability (*e.g.*, for period under audit); and liabilities for employee benefits (*e.g.*, pensions, bonuses, vacations) to the extent they are debt.[211] As noted above, surplus does not include a direct write-off of an asset.[212] Redeemable preferred stock is excluded from surplus if it is debt.[213] The amount paid for treasury shares is also not included in surplus.[214] Additional rules apply to foreign currency transactions.[215]

Stated Capital. The stated capital rule[216] now provides that stated capital equals the sum of (1) the par value of all par valued shares of the corporation; (2) the consideration fixed by the corporation pursuant to Article 2.5 of the Texas Business Corporation Act for shares issued without par value, less the amount of consideration paid to the corporation, which may be less than all the consideration, that the board allocated to surplus up to sixty days after the corporation issued the shares; and (3) other amounts transferred to the stated capital of a corporation, whether upon payment of a share dividend or upon resolution by the board to transfer all or part of the surplus to stated capital.[217] The revised version of the rule further includes treasury shares in stated capital until such shares are cancelled and restored to the status of authorized but unissued shares, and includes redeemable preferred stock in stated capital unless it is debt.[218]

Gross Receipts. By its terms, the new gross receipts rule applies to franchise tax reports originally due on or after January 1, 1988.[219] The rule, which

208. *Id.* § 3.405(d)(1)(C).
209. *Id.* § 3.405(d)(3).
210. *Id.* § 3.405(e).
211. *See infra* note 217 and accompanying text.
212. 34 TEX. ADMIN. CODE § 3.405(e)(10).
213. *Id.* § 3.405(e)(8).
214. *Id.* § 3.405(e)(3).
215. *Id.* § 3.404 (eff. June 28, 1988, 13 Tex. Reg. 2971).
216. *Id.* § 3.404(a).
217. *Id.* § 3.404(b), (c).
218. *Id.* § 3.403. *See also id.* § 3.391 (accounting methods) discussed *supra*, which also applies to determining gross receipts.
219. *Id.* § 3.403(b)(5), which excludes:

> [S]eparately recorded reimbursements of actual expenses paid to third parties, bad debt recoveries, recovery of basis on sale or condemnation of a capital asset or investment, repayment of loan principal, amounts received for issuance of capital stock, refund of taxes (except interest thereon), equity earnings of an

includes several definitions, defines revenue as including, unless otherwise specifically provided for, any funds, from any source, recognized by the corporation, excluding certain specifically listed items.[220] The rule also sets forth a series of rules for determining gross receipts, as well as a separate series of rules for allocating gross receipts.[221] The rules contain specific instructions for determining what constitutes receipts, including sales to which the "throwback rule" applies.[222]

The new rule specifically provides that expense allocations by a parent among one or more of its subsidiaries, other than income tax allocations for consolidated return purposes, produce gross receipts for the parent regardless of whether the parent actually receives cash from the subsidiaries unless an agency relationship exists.[223] The rule further provides that all revenues of a newspaper transacting its primary business activities in Texas are Texas receipts.[224] The rule, however, excludes revenues from the sale of newspapers outside of Texas.[225] All revenues of a radio or television station that broadcasts or transmits from Texas stations are Texas receipts, even if some of the audience is outside Texas.[226] The rule excludes revenue from programs that are sold or leased to the national media for broadcasting or transmitting.[227]

The comptroller set forth the methodology for calculating net gains and losses on Texas sales.[228] The location-of-the-payor test continues to exist.[229] Indeed, this rule specifically allocates the net gain on sales of intangibles held as capital assets or investments to the location of the payor.[230] The rule provides a special exception for dividends and/or interest received from a national bank,[231] from the United States Treasury or other Government debt, from GNMA, FNMA, or FHLMC mortgage bank securities or certificates, and from partnership receipts.[232]

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investee, foreign dividend gross-ups allowed by the Internal Revenue Service and intercorporate tax allocations.

220. *Id.* § 3.403(d).

221. *Id.* § 3.403(d)(1).

222. *Id.* § 3.403(d)(3).

223. *Id.* § 3.403(d)(10).

224. *Id.*

225. This rule is an interesting contrast to 34 TEX. ADMIN. CODE § 3.286 (eff. Aug. 25, 1988, 13 Tex. Reg. 3988), which treats advertising as intended for Texas customers for sales tax purposes as if 75% of the customers are located in Texas.

226. *Id.* § 3.403(d)(11).

227. *Id.* § 3.403(e)(1).

228. Indeed, the rule specifically provides that net gain on sales of intangibles held as capital assets or investments is allocated to the location-of-the payor. *Id.*

229. *Id.*

230. *Id.* § 3.403(e)(5).

231. With respect to partnerships, the rule provides that a corporation's share of net profits are allocated to the principal place of business of the partnership which is the location of the daily operations or, if the partnership operates in more than one state, its commercial domicile. *Id.* § 3.403(e)(9). A corporation's share of the partnership's gross receipts may be used as gross receipts if allowed as revenue by GAAP. *Id.* (under former policy, a corporation was allowed to choose between net profit and gross receipts methods).

232. *Id.* § 3.403(e)(12). It is not yet clear whether this test is the same as the "essence of the transaction" test previously used by the Comptroller. Service receipts are allocated to the

The new rule encompasses newly taxable services by providing that if a transaction involves elements of a sale of tangible personal property and a service, and if no documentation exists to show separate charges, "the predominant aspect of the transaction" controls the allocation of charges.[233] The comptroller has issued regulatory guidance to provide for allocation of capital and tax among a bank's principal office and qualified branch facilities.[234]

Pursuant to Section 171.084 of the Tax Code,[235] certain solicitation activities will not cause a corporation to be doing business in Texas.[236] Although a corporation need not apply for the exemption provided by this section, a foreign corporation that has obtained a certificate of authority or given notification to the comptroller that it is doing business in Texas must also inform the comptroller in writing of the exemption by the due date of the first report for which the payment is due.[237] Thereafter, the corporation must send written notice to the comptroller only when the corporation no longer qualifies for the exemption.[238] A foreign corporation that has neither obtained a certificate of authority nor notified the comptroller that it is doing business should send written notice to the comptroller only when the corporation no longer qualifies for the exemption.[239] The rule also provides examples of corporations that exceed the limits on solicitation in Texas.[240] These examples illustrate both that the initial period of a corporation without a certificate of authority begins on the date of its first trade show in Texas and that the 120 hour statutory limit is computed on the basis of a 24 hour day.[241]

III. PROPERTY TAX

A. Application of Tax

In *Coastal States Crude Gathering Co. v. State Property Tax Board*[242] the Austin court of appeals held that section 24.01(5) of the Tax Code (as in effect for the tax year at issue),[243] which provided for taxing the intangible value of the transportation operation of a business's oil pipelines and common carrier pipelines engaged in the transportation of oil, imposes a tax on only the intangible value of oil transportation activity and not on the intangible value of the taxpayer's entire transportation operations.[244] The Property

location where the service is performed, and receipts for the procurement of services are allocated to the place where the service procurement is performed. *Id.* §§ 3.403(e)(13), (14).

233. *Id.* § 3.411.

234. TEX. TAX CODE ANN. § 171.084 (Vernon Supp. 1988).

235. *Id.*

236. 34 TEX. ADMIN. CODE § 3.414(c)(1) (eff. Dec. 28, 1987, 12 Tex. Reg. 4702).

237. *Id.*

238. *Id.* § 3.414(c)(2).

239. *Id.* § 3.414(d).

240. *Id.* § 3.414(e).

241. 747 S.W.2d 61 (Tex. App.—Austin 1988, no writ).

242. A 1987 amendment to section 24.01 of the Tax Code deleted motor bus carriers and common or contract motor carriers from the list of businesses taxed under that section.

243. 747 S.W.2d at 63.

244. *Id.* at 62.

Tax Board asserted that because the statute uses the term "business" rather than "activity," all of a taxpayer's transportation operations are taxed if the taxpayer engages in any oil transportation activities.[245] The court disagreed, stating that the more logical interpretation of the statute is that it taxes only the business activity of transporting oil.[246]

Several attorney general opinions interpreted the constitutionality of tax legislation passed by the 70th Legislature. In one of these opinions,[247] the Attorney General ruled on the constitutionality of legislation authorizing municipal utility districts to issue bonds to provide facilities that would serve only a defined area or some designated real property within a defined area.[248] The question before the Attorney General concerned whether the legislation violated the "equal distribution" requirement of article XVI, section 59 of the Texas Constitution,[249] which essentially provides that taxes must be fairly proportioned according to the benefit to the taxed property.[250] Because the legislation mandated that only property within a defined area can be taxed to pay the debt service on the utility bonds, the Attorney General ruled that the statute met the "equal distribution" standard,[251] especially in light of the fact that the "equal distribution" standard has not been interpreted to require exact apportionment.[252]

The Attorney General ruled[253] that the additional penalty under section 33.01 of the Tax Code[254] could not be used to defray the taxing unit's costs of collecting delinquent taxes but must be used solely to compensate attorneys who have contracted to collect such taxes.[255] The taxing authority argued that a county could impose the maximum fifteen percent penalty allowed under section 33.01 of the Tax Code and then pay the attorney collecting the delinquent taxes only ninety percent of the penalty while retaining the rest of the penalty as reimbursement of the county's costs of collecting delinquent taxes. The Attorney General relied on legislative history and court decisions, which referred to the penalty as "attorneys' fees," in reaching his conclusion.[256]

Both the courts and the Attorney General issued opinions regarding the constitutionality of property tax rollback elections. In *Vinson v. Burgess*[257]

245. *Id.* at 63. The court stated that any other conclusion would lead to absurd results because shippers who, for example, transported only one gallon of oil would be taxed on their entire transportation operation. *Id.*

246. *Id.*

247. *Id.*

248. Op. Tex. Att'y Gen. No. JM-836 (1987).

249. TEX. CONST. art. XVI, § 59.

250. Op. Tex. Att'y Gen. No. JM-836 (1987).

251. *See* Dallas County Levee Dist. No. 2 v. Looney, 207 S.W. 310 (Tex. 1918) (stating that Texas Constitution does not require legislature to tax exactly in proportion to benefit derived).

252. Op. Tex. Att'y Gen. No. JM-857 (1988).

253. TEX. TAX CODE ANN. § 33.01 (Vernon 1982).

254. *Id.*

255. *Id.*

256. 755 S.W.2d 481 (Tex. App.—Fort Worth 1988, writ granted).

257. The *Vinson* case concerns the currently effective Section 26.07 of the Tax Code, which

the Fort Worth court of appeals held that section 26.07 of the Tax Code,[258] which authorizes property tax rate rollback elections for taxing units other than school districts, is unconstitutional insofar as the statute applies to counties.[259] The court reasoned that the legislation was contrary to the constitutional provision authorizing commissioners courts to set tax rates and providing that such rates are to remain in effect for the entire taxable year.[260] In response to the taxpayer's argument that the rollback statute as it applied to counties was a constitutional legislative enactment, the court stated that the constitution did not authorize the legislature to delegate its legislative power directly to the people; rather, the taxpayer's representatives must exercise such power.[261] Because the legislature could not delegate its constitutional powers directly to the people by allowing a direct election, it could not delegate to the people those powers conferred by the constitution on other governmental bodies, such as the commissioners court, by direct election.[262]

The Attorney General issued two opinions on the constitutionality of property tax rollback elections. These opinions followed a 1987 Attorney General opinion[263] declaring, for reasons similar to those in *Vinson*, section 26.07 of the Tax Code unconstitutional insofar as it applied to counties.[264] In opinions JM-835[265] and JM-859,[266] the Attorney General held that property tax rollback elections for school districts and hospital districts, respectively, were constitutional. According to the Attorney General, the Texas Constitution does not directly authorize either school districts or hospital districts to set tax rates; thus, the Legislature could delegate that responsibility to the voters in those districts. The Attorney General distinguished these facts from those regarding rollback elections for counties because the constitution did directly authorize the commissioners courts to set tax rates.[267]

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was amended in 1987. *See* Act of June 17, 1987, ch. 457, § 13, 1987 Tex. Sess. Law Service 4060 (Vernon); Act of June 20, 1987, ch. 947, § 9, 1987 Tex. Sess. Law Service 6360 (Vernon).

258. 755 S.W.2d at 484.

259. *Id.* The court of appeals cites Op. Tex. Att'y Gen. No. JM-792 (1987) in holding that § 26.07 of the Tax Code is unconstitutional as applied to counties. *See infra* note 263 and accompanying text.

260. 755 S.W.2d 485-86.

261. *Id.* In Winborne v. Commissioners Court of Ellis County, 757 S.W.2d 876, 880 (Tex. App.—Waco 1988, writ granted), the Waco Court of Appeals disagreed with the Fort Worth Court of Appeals and held that rollback elections under Section 26.07 of the Tax Code were not unconstitutional. The court found no express or implied prohibition in the constitution against voters holding an election to reject a commissioners court tax ruling. *Id.* at 879. The conflict between *Winborne* and *Vinson* should be resolved by the Texas Supreme Court.

262. Op. Tex. Att'y Gen. No. JM-792 (1987).

263. *Id.*

264. Op. Tex. Att'y Gen. No. JM-835 (1987).

265. Op. Tex. Att'y Gen. No. JM-859 (1988).

266. The Attorney General stated that the Texas Constitution conferred "explicit authority" on the commissioners court to set rates and levy taxes. *Id.* He concluded that the taxing power of school districts, however, was subject to the legislature's power to enact laws setting rates. Op. Tex. Att'y Gen. No. JM-833 (1988). This same rationale was applied in opinion JM-859.

267. 742 S.W.2d 424 (Tex. App.—Dallas 1987, writ denied).

B. Specific Exemptions

The Dallas court of appeals in *Dallas County Appraisal District v. The Leaves, Inc.*[268] held that a Christian Science nursing home should not be denied its property tax exemption merely because a majority of its patients were able to pay for their care, the home preferred Christian Scientists as patients, and the home practiced only Christian Science healing methods.[269] In determining whether the nursing home provided services without regard to the beneficiaries' ability to pay, the court stated that reliance upon the percentage of patients which are able to pay for their own care should not be the controlling factor; rather, the total operation of the organization must be examined.[270] In this case, although the nursing home's benevolence fund paid less than two percent of patient charges, the home operated at a fourteen percent loss during the year in question. The taxpayer therefore effectively subsidized fourteen percent of total patient care costs.[271] Based on the overall operations of the nursing home, the court concluded that it provided services without regard to the patients' ability to pay.[272] The court also stated that although the home preferred Christian Scientists as patients, sufficient evidence existed in the record, such as the nursing home's policy to admit all patients for whom room existed, to support the district court's judgment that the nursing home operated as a purely public charity.[273]

Several noteworthy decisions by the Texas courts of appeals addressed the qualified open-space land exemption. In *Riess v. Appraisal District of Williamson County*[274] the Austin court of appeals held that a taxpayer, in attempting to establish that land was qualified open-space land, need not prove that the land was used to the "degree of intensity generally accepted in the area"[275] during past years in order to prove that the land was historically devoted principally to agricultural use.[276] Instead the taxpayer must only

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268. *Id.* at 429. *See* City of Austin v. University Christian Church, No. C-6294 (Tex. 1988) (not yet reported) (holding that church parking lot used on weekdays for commercial purposes may be exempt). *See also* El Paso Central Appraisal Dist. v. The Evangelical Lutheran Good Samaritan Soc'y Inc., No. 08-87-00251-CV (Tex. App.—El Paso Oct. 26, 1988, no writ) (not yet reported). In this case, the El Paso court of appeals held that a non-profit corporation that operated an apartment complex for retired people who do not need immediate medical care and a nursing home for those who need immediate medical care is entitled to tax-exempt status as to all of its operations even though the society engages in other benevolent work besides the activities specified in section 11.18(c) of the Tax Code. *Id.*

269. 742 S.W.2d at 427-28.

270. *Id.* at 427.

271. *Id.* at 429.

272. *Id.* The court noted that even if the nursing home were to discriminate on the basis of religion, such fact would not be a sufficient basis to prevent the home from qualifying as a purely public charity. *Id.* The requirement that an organization be a purely public charity was never meant to require that a charity cannot limit its care to those "belonging to a certain sect or fraternal order, or color, or class." *Id.* at 429, *quoting* City of Houston v. Scottish Rite Benevolence Ass'n, 111 Tex. 191, 199, 230 S.W. 978, 981 (1921).

273. 735 S.W.2d 633 (Tex. App.—Austin 1987, no writ).

274. TEX. TAX CODE ANN. § 23.51(1) (Vernon Supp. 1988). Effective January 1, 1988, the Texas Legislature expanded the definition of qualified open-space land by including in the definition land historically used for timber or forest products. *Id.*

275. 735 S.W.2d at 637-38.

276. *Id.*

satisfy the "intensity of use" standard for the current year.[277] Therefore, although the taxpayer's agricultural production was negligible in some past years, he nonetheless satisfied the historical use test because the land was still devoted principally to agricultural use during those years.[278]

The Houston (14th District) court of appeals held in *Peil v. Waller County Appraisal District*[279] that the chief appraiser of an appraisal district could require new applications for land previously appraised as qualified open-space land without making individual determinations that each specific parcel of land subject to the new application requirement was no longer eligible for the exemption.[280] Section 23.54(e) of the Tax Code[281] provides that the chief appraiser may require owners of land previously appraised as open-space land to file new applications to confirm that the land is currently eligible if he has good cause to believe that the land's eligibility for such exemption has ended.[282] The chief appraiser's belief that the taxpayer's property may have ceased to qualify as open-space land because the land is located in an area of frequent change in use was sufficient justification to require a new exemption application.[283]

The San Antonio court of appeals held in *Bower v. Edwards County Appraisal District*[284] that a taxpayer was not entitled to a special appraisal for agricultural use where the sole use of the land was for wild deer hunting.[285] The State Property Tax Board's Guidelines[286] for the valuation of agricultural land clearly excluded the taxpayer's deer raising activities from the definition of agricultural use, but the taxpayer contended that the Guidelines exceeded the Property Tax Board's rulemaking authority.[287] The court responded that rules based on a grant of legislative power must be upheld if reasonable, and the rules at issue met this test.[288]

The voters passed three proposed constitutional amendments relating to property taxation placed on the November 1987 election ballot, all of which related to exemptions. These amendments (1) authorize the legislature to exempt all personal property not otherwise exempted from the Texas Constitution except personal property used as a residential dwelling or used for the production of income,[289] (2) limit the property taxes that the legislature may

277. The administrative rule applying the "intensity of use" standard in determining whether land was historically devoted principally to agricultural use was held to be invalid. *Id.* at 638.

278. 737 S.W.2d 33 (Tex. App.—Houston [14th Dist.] 1987, no writ).

279. *Id.* at 35-36.

280. TEX. TAX CODE ANN. § 23.54(e) (Vernon 1982).

281. *Id.*

282. 737 S.W.2d at 35.

283. *Id.*

284. 752 S.W.2d 629 (Tex. App.—San Antonio 1988, writ granted).

285. *Id.* at 631.

286. The Manual for the Appraisal of Agricultural Land was amended by the State Property Tax Board in June 1988.

287. 752 S.W.2d at 632.

288. *Id.* at 633.

289. TEX. CONST. art. VIII, § 1(d). The exemption by the legislature of all other tangible personal property except residential dwellings and property used for the production of income, however, may be vetoed by local government bodies. *Id.*

impose on the residence homestead of the surviving spouse of an elderly person,[290] and (3) authorize the legislature to exempt certain idle mobile marine equipment, which the legislature has already done.[291]

An Attorney General opinion[292] held that the local option exemption for non-income producing boats enacted by the 70th Texas Legislature,[293] effective on May 26, 1987, was not applicable to such boats for the 1988 tax year in taxing jurisdictions that had certified their tax rolls before May 26, 1987.[294] The Attorney General reasoned that if the exemption were applied to all applicable boats which were already on the tax rolls on the effective date of the statute, the exemption would violate the Texas Constitution because the constitution prohibits the state from applying an exemption retroactively to a liability that has already matured[295] and prohibits the state from granting public funds to any individual or entity without a public purpose.[296]

C. Procedure

Texas courts generally continued to interpret strictly the procedural requirements for property tax controversies. In *Parr v. State*[297] the San Antonio court of appeals held that a delinquent tax roll could not be considered as prima facie evidence of the taking unit's cause of action for delinquent taxes because the description of property in the tax roll was insufficient to identify and locate the property.[298] Section 33.47 of the Tax Code[299] provides that delinquent tax records constitute prima facie evidence of the correct amount of taxes due by the defendant.[300] In order for a description to be sufficient, it must identify and locate the property.[301] The delinquent tax roll described the property only by abstract number, name of original grantee or addition and number of acres sought to be taxed, *i.e.*, 1000 acres in Abstract 227. In this case, the tax roll was defective because the specific acres could not be located in the abstract.[302]

In *Dallas County Appraisal District v. Institute for Aerobics Research*[303]

290. TEX. CONST. art. VIII, § 1-b(d).
291. TEX. CONST. art. VIII, § 1-i. See TEX. TAX CODE ANN. § 11.271 (Vernon Supp. 1988) (implementing constitutional amendment).
292. Op. Att'y Gen. No. JM-893 (1988).
293. *See* TEX. TAX CODE ANN. § 11.14 (Vernon Supp. 1988).
294. Op. Att'y Gen. No. JM-893 (1988).
295. *See* TEX. CONST. art. III, § 55.
296. *See* TEX. CONST. art. III, § 51.
297. 743 S.W.2d 268 (Tex. App.—San Antonio 1987, no writ).
298. *Id.* at 270.
299. *Parr* actually interpreted TEX. REV. CIV. STAT. ANN. art. 7326 (repealed Jan. 1, 1982). This statute was repealed in 1982 and was codified in section 33.47 of the Tax Code. TEX. TAX CODE ANN. § 33.47 (Vernon 1982 and Supp. 1988).
300. TEX. TAX CODE ANN. § 33.47 (Vernon 1982 and Supp. 1988).
301. *See* Electra Indep. School District v. W.T. Waggoner Estate, 140 Tex. 483, 488, 168 S.W.2d 645, 649-650 (1943) (setting forth requirements of sufficient property description).
302. 743 S.W.2d at 270. The court held the attempted levy in this case to be invalid for other reasons, such as the absence of some members of the commissioners court from the meeting in which the attempted levy was made. *Id.* at 271.
303. 751 S.W.2d 860 (Tex. 1988).

the Texas Supreme Court held that appraisal districts need not file an appeal bond under section 42.28 of the Tax Code[304] to appeal a district court decision.[305] Section 42.28 of the Tax Code exempts the chief appraiser, the county, the State Property Tax Board and the commissioners court from posting an appeal bond in appealing the final judgment of the district court.[306] A divided Texas Supreme Court ruled that the county exemption implicitly exempts the appraisal district because the appraisal district is a governmental agent of the county for purposes of appraising property for ad valorem taxation.[307]

In a case in which a taxing authority was caught by the strict interpretation of the procedural requirements for a property tax controversy, the Eastland court of appeals in *First Union Real Estate Investments v. Taylor County Appraisal District*[308] held that a taxpayer who names an agent to handle its property tax protest in a fiduciary letter of authorization sent to the appraisal review board, but does not expressly state that such agent is to receive all notices from the taxing authority, does not receive notification from the taxing authority regarding notice of denial that was sent only to the taxpayer's agent.[309] The taxpayer did not enter a checkmark in front of the paragraph on the fiduciary letter of authorization that asked the board to send to the agent all assessment notices and tax statements relative to the land involved but did check the box in front of the paragraph stating that the agent had full authority to handle the assessment. The paragraph checked further stated that the board was to "divulge to [the agent] any and all information which we have submitted to you."[310] The court ruled that the taxpayer's limit on the agent's authority was communicated to the board by not checking the appropriate square.[311]

IV. OTHER SIGNIFICANT DEVELOPMENTS

The "administrative services tax" imposed on third party administrators

304. TEX. TAX CODE ANN. § 42.28 (Vernon 1982).

305. *Id.* at 861-62. The Texas Supreme Court reversed the Dallas court of appeals. For a discussion of the Dallas court of appeals' decision see Ohlenforst & Dorrill, *Annual Survey of Texas Law: Taxation*, 42 SW. L.J. 633, 655 (1988). Four justices dissented in the supreme court decision. *See* 751 S.W.2d at 862-63.

306. TEX. TAX CODE ANN. § 42.28 (Vernon 1982).

307. 751 S.W.2d at 861. The governmental agency of an entity excused from filing an appeal bond is itself excused from filing such bond. *Id. See also* El Paso Cent. Appraisal Dist. v. Montrose Partners, 754 S.W.2d 797, 798 (Tex. App.—El Paso 1988, writ denied) ("When a governmental entity is exempt from filing an appeal bond, its governmental board is also exempt.").

308. 758 S.W.2d 380 (Tex. App.—Eastland 1988, no writ).

309. *Id.* at 381.

310. *Id.* at 382.

311. *Id.* at 383. In a case related to Texas property taxes, the Austin Court of Appeals held in Kirby v. Edgewood I.S.D., 761 S.W.2d 859, 867 (Tex. App.—Austin 1988, no writ), that the present school financing system in Texas is not in violation of the Texas Constitution and reversed the judgment of the Texas district court, which held that the current state system of funding discriminates against low-wealth school districts. The petitioners have filed an application for writ of error to the Texas Supreme Court.

of welfare benefit plans[312] has given rise to numerous suits challenging the constitutionality of the tax.[313] These suits focus not only on substantive issues regarding preemption of the Texas tax by federal law,[314] but also on procedural issues regarding whether suit lies in federal or state court.[315] These cases also focus on the ability of taxpayers to force the state to refund amounts paid in the event the tax is held unconstitutional.[316] Although this tax is technically part of the Texas Insurance Code, many of the issues raised by these cases are of critical importance to Texas state taxes. Other suits have been filed to challenge the constitutionality of the licensing fee imposed on third party administrators.[317] Unfortunately, resolving the issues raised by these cases is likely to be a long, difficult process.

The Select Committee on Tax Equity released written conclusions at the end of the survey period.[318] The Committee's conclusions comprise separate reports from each of four subcommittees: the Income Tax and Lottery Working Group, the Business Tax Working Group, the Local Issues Working Group, and the Sales and Excise Tax Working Group. The Committee focused on both policy matters and practical suggestions, and it proposed several approaches to long-term reform of the Texas tax system in general, and of the franchise tax in particular. The recommendations of the Committee and the actions of the 1989 legislature ensure that the upcoming survey period will reflect additional changes in Texas taxation.

312. This tax is technically part of the Texas Insurance Code. TEX. INS. CODE ANN. art. 4.11A (Vernon Supp. 1988).

313. *See, e.g.*, American Airlines, Inc. v. [Doyce R.] Lee, CA No. A-88-CA-186 (W.D. Tex.) and McDonald's Corp. v. [Doyce R.] Lee, CA No. 442,014 (14th Dist. Court Travis County).

314. The tax appears to be pre-empted, at least to some extent, by Section 514(a) of the Internal Revenue Code of 1986, as amended (ERISA).

315. The majority of the suits filed during the survey period were filed in state district court. *E.g.*, *McDonald's Corp.*, *supra* note 314.

316. The ability of a state to refuse to refund taxes in this circumstance has been the subject of litigation in many other forums as well. *See, e.g.*, *Tyler Pipe Inc.*, 107 S. Ct. 2810, 97 L. Ed.2d 199 (1987); National Can Corp. v. Dept. of Revenue, 749 P.2d 1286, 1287 (Wash. 1988).

317. In addition, the United States Supreme Court has agreed to hear two cases involving taxpayers' right to refunds of state taxes that were held unconstitutional. McKesson Corp. v. Florida, 109 S. Ct. 389, 102 L. Ed.2d 378 (1988); American Trucking Ass'n Inc. v. Smith, 109 S. Ct. 389, 102 L. Ed.2d 378 (1988).

318. The legislature authorized this committee to study and make recommendations as to major state and local tax issues. Act of Mar. 30, 1987, ch. 10, 1987 Tex. Sess. Law Serv. 52 (Vernon).